Washington State Auditor's Office

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## Financial Statements Audit Report

# Valley Water District

**Pierce County**

**For the period January 1, 2014 through December 31, 2014**

**Published October 29, 2015**

**Report No. 1015461**

# Washington State Auditor's Office

October 29, 2015

Board of Commissioners
Valley Water District
Puyallup, Washington

## Report on Financial Statements

Please find attached our report on the Valley Water District's financial statements.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

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**Valley Water District**
**Pierce County**
**January 1, 2014 through December 31, 2014**

Board of Commissioners
Valley Water District
Puyallup, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Valley Water District, Pierce County, Washington, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated October 15, 2015. As discussed in Note 11 to the financial statements, during the year ended December 31, 2014, the District implemented Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

Jan M Jutte

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

October 15, 2015

# INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

**Valley Water District**
**Pierce County**
**January 1, 2014 through December 31, 2014**

Board of Commissioners
Valley Water District
Puyallup, Washington

## REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Valley Water District, Pierce County, Washington, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 9.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Valley Water District, as of December 31, 2014, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## Matters of Emphasis

As discussed in Note 11 to the financial statements, in 2014, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

## Other Matters

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2015 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Jan M Jutte

JAN M. JUTTE, CPA, CGFM

ACTING STATE AUDITOR

OLYMPIA, WA

October 15, 2015

# FINANCIAL SECTION

**Valley Water District**
**Pierce County**
**January 1, 2014 through December 31, 2014**

## REQUIRED SUPPLEMENTARY INFORMATION



## BASIC FINANCIAL STATEMENTS

## Brief Discussion of the Basic Financial Statements

The District's financial statements include a Statement of Net Position, a Statement of Revenues, Expenses & Changes in Fund Net Position, a Statement of Cash Flows, and Notes to the Financial Statements. The financial statements are prepared using the accrual basis of accounting and conform to generally accepted accounting principles as applicable to proprietary funds of governments. The intent of the management's discussion and analysis is to provide highlights of the District's financial activities for the year ended December 31, 2014. Readers are encouraged to read this section in conjunction with the accompanying financial statements.

The statement of net position provides a record, or snap shot, of the assets and liabilities of the District at the close of the year. It provides information about the nature and amounts of investments in resources (assets), and the obligations to District creditors (liabilities). It provides the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

The statement of revenues, expenses, and changes in net position presents the results of the business activities over the course of the year. This information can be used to determine whether the District has successfully recovered all its costs through its user fees and other charges, profitability and credit worthiness.

The statement of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operating, financing, and investing activities over the course of the year. It presents information regarding where cash came from and what it was used for.

The notes to the financial statements provide useful information regarding the District's significant accounting policies, explain significant account balances and activities, certain material risks, estimates, obligations, commitments, contingencies, and subsequent events, if any.

## Condensed Comparative Statement of Net Position

The following condensed statements of net position present an overview of the District's financial position as of December 31, 2014 and 2013.

| | 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Current Assets | $ 2,569,113 | $ 2,080,071 |
| Noncurrent Assets: | | |
| Capital Assets - Net | 14,473,503 | 14,491,946 |
| Other | 21,188 | 24,435 |
| Total Assets | $ 17,063,804 | $ 16,596,452 |
| **Deferred Outflow of Resources** | | |
| Deferred Loss on Refunding | $ 39,257 | $ 48,588 |

| | 2014 | 2013 |
|---|---|---|
| **Liabilities** | | |
| Current Liabilities | $ 935,166 | $ 877,499 |
| Noncurrent Liabilities: | | |
| Long-Term Debt | 8,986,216 | 9,775,040 |
| Other | 20,943 | 15,999 |
| Total Liabilities | $ 9,942,325 | $ 10,668,538 |
| **Net Position** | | |
| Net Investment in Capital Assets | $ 4,758,909 | $ 4,047,627 |
| Restricted for Capital Projects | 121,411 | 117,258 |
| Unrestricted | 2,280,416 | 1,811,617 |
| Total Net Position | $ 7,160,736 | $ 5,976,502 |

## Analysis of the Condensed Comparative Statement of Net Position

Assets

Current assets consist of cash and cash equivalents held in the maintenance, construction and revenue bond funds as well as inventory, prepaid expenses, accrued interest and accounts receivable. Current assets increased by $489,042 in 2014. The increase was primarily due to increases in cash held in non-restricted funds at year end. The cash in these funds increased by $464,441. Cash balances in the various funds vary from year to year based on the income from operations, expenses paid for operations and construction costs, transfers into other funds, borrowings and debt service payments. Accounts receivable from developers increased by $25,812. The remaining balances did not change significantly in 2014.

Noncurrent assets

Net Capital Assets, which include land, construction work in progress, utility plant, equipment & intangible assets, less accumulated depreciation, decreased by $18,443 in 2014. This decrease was driven by an increase in capital spending in the amount of $442,455 offset by an increase in depreciation of $460,898.

Other noncurrent assets, which is made up of unamortized bond insurance decreased by $3,247. The decrease was due to the 2014 amortization expense.

Liabilities

Current liabilities increased by $57,667. Most of this increase was the result of an increase in the current portion of long-term debt.

Noncurrent liabilities

Long-term debt decreased by $788,824 in 2014. This decrease was caused by principal payments on the long-term debt. See Note 5 showing the detail of changes to the long-term debt.

The District's compensated absences increased by $4,944 over 2013. This varies from year to year based on the unused vacation & sick leave pay at the end of the year.

Net Position

Net position consists of total assets minus total liabilities. Net position increased by $1,184,234 in 2014. Over time, increases or decreases in the District's net position are an indicator of the District's overall financial growth. An increase in net position is a positive sign of the District's financial strength.

## Condensed Comparative Statement of Revenues, Expenses & Changes in Net Position

The following statements of revenues, expenses and changes in fund net position present the annual surplus or deficiency of revenues over expenses (the change in net position):

| | 2014 | 2013 |
|---|---|---|
| **Revenues** | | |
| Water Operating Revenues | $ 2,669,130 | $ 2,505,238 |
| Nonoperating Revenues | 8,143 | 71,897 |
| Total Revenues | $ 2,677,273 | $ 2,577,135 |
| **Expenses** | | |
| Operating Expenses | $ 1,284,055 | $ 1,247,334 |
| Depreciation | 460,898 | 456,709 |
| Nonoperating Expenses | 299,137 | 323,223 |
| Total Expenses | $ 2,044,090 | $ 2,027,266 |
| Change in Net Position before Capital Contributions | $ 633,183 | $ 549,869 |
| Capital Contributions | 551,051 | 294,268 |
| Change in Net Position | $ 1,184,234 | $ 844,137 |
| **Total Net Position, January 1** | 5,976,502 | 5,271,023 |
| Change in Application of Accounting Principle | - | (138,658) |
| **Total Net Position, December 31** | $ 7,160,736 | $ 5,976,502 |

## Analysis of the Condensed Comparative Statement of Revenues, Expenses & Changes in Fund Net Position

Revenues

Water operating revenues increased by $163,892 in 2014 primarily due to a 5% rate increase enacted during the year, as well as an increase in the customer base and a warm dry summer.

Interest income decreased by $175 primarily due to the continued low interest rates on funds held by the District.

## Analysis of the Condensed Comparative Statement of Revenues, Expenses & Changes in Fund Net Position (Continued)

Expenses

Operating expenses, including depreciation, increased by $40,910 in 2014. Water costs were higher by $12,598 due to increased consumption caused by an increase in the customer base and the warmer, dryer summer. Operating expenses also increased due to increases in wages of $44,271 and business tax expense of $14,642. Other operating expenses remained consistent with the prior year.

Nonoperating expenses consist of interest expense on long-term debt. Interest expense decreased by $24,086 in 2014 primarily due to decreasing principal balances on long-term debt as principal payments are made and to the capitalizing of $36,243 of interest on the Chinook Treatment Plant project.

Capital Contributions

Capital contributions increased by $256,783 in 2014 in part due to a Bill of Sale recorded in 2014 from a developer in the amount of $134,013, along with higher collections during the year. The amount of capital contributions varies from year to year depending on development projects in the District.

Change in Net Position

Net position increased by $1,184,234 during 2014, reflecting the fact that total revenues exceeded total expenses. Other than the bond covenant restrictions on the use of cash and investments being held in the bond funds, there are no restrictions or commitments which would significantly affect availability of fund resources for future use.

## Analysis of Overall Financial Condition

The District's financial condition improved in 2014 with adequate liquid assets and positive operating cash flow.

## Capital Assets

Capital assets consist of land, construction in progress, utility plant and equipment. The total decrease in the District's investment in capital assets for the current year was $18,443. The principal projects included in the 2014 capital spending were the Chinook Treatment Plant, along with the McAlder Well and the purchase of a pickup truck. Over the next five years it is anticipated that capital spending will be in the range of $3,000,000 - $3,500,000. See Note 3 for more information.

Capital assets activity for the year ended December 31, 2014 was as follows:

| | Balance 12/31/14 | Balance 12/31/13 | Change |
|---|---|---|---|
| Land | $ 845,964 | $ 845,964 | $ - |
| Construction in Progress | 1,870,917 | 1,707,560 | 163,357 |
| Utility Plant | 16,307,287 | 16,091,939 | 215,348 |
| Machinery & Equipment | 621,514 | 589,200 | 32,314 |
| Intangibles | 205,094 | 205,094 | - |
| Accumulated Depreciation | (5,377,273) | (4,947,811) | (429,462) |
| Total Capital Assets, Net | $ 14,473,503 | $ 14,491,946 | $ (18,443) |

## Long-Term Debt

At December 31, 2014, the District had total Public Works Trust Fund loans outstanding of $2,373,070, total revenue bonds outstanding, net of unamortized bond premium of $7,177,671, and a Department of Agriculture loan in the amount of $224,298. The total long-term debt of the District decreased by $742,303 during 2014. This is due to principal payments in the amount of $738,416 made on revenue bonds, Public Works Trust Fund loans and the Department of Agriculture loan and amortization of the bond premium in the amount of $3,887. See Note 5 for more information.

## Additional Comments

In 2014 there was a 5% increase in water rates. As the customer base is not expected to experience significant growth, revenue growth will likely be driven by rate increases.

The District does plan on a new bond issue in 2015 for approximately $3,500,000 to fund upcoming capital spending projects.

For more information please refer to the notes attached to the financial statements.

Valley Water District
Statement of Net Position
December 31, 2014

| | |
|---|---|
| ASSETS | |
| Current Assets | |
| Cash & Cash Equivalents | $ 1,953,487 |
| Accrued Interest Receivable | 110 |
| Receivables: | |
| Customer Accounts Receivable | 237,334 |
| Accrued Utility Revenue | 94,742 |
| Receivable - Developers & Other | 34,111 |
| Restricted Assets: | |
| Cash & Cash Equivalents | 153,283 |
| Accrued Interest Receivable | 10 |
| Inventory | 72,618 |
| Prepaid Insurance | 23,418 |
| Total Current Assets | $ 2,569,113 |
| Noncurrent Assets | |
| Unamortized Bond Insurance | $ 21,188 |
| Capital Assets Not Being Depreciated: | |
| Land and Land Rights | 845,964 |
| Construction Work in Progress | 1,870,917 |
| Capital Assets Being Depreciated: | |
| Plant | 16,307,287 |
| Machinery & Equipment | 621,514 |
| Intangibles | 205,094 |
| Less Accumulated Depreciation | (5,377,273) |
| Total Capital Assets | 14,473,503 |
| Total Noncurrent Assets | $ 14,494,691 |
| Total Assets | $ 17,063,804 |
| DEFERRED OUTFLOW OF RESOURCES | |
| Deferred Loss on Refunding | $ 39,257 |
| Total Deferred Outflow of Resources | $ 39,257 |

See accompanying notes to the financial statements

Valley Water District
Statement of Net Position
December 31, 2014

| | |
|---|---|
| LIABILITIES | |
| Current Liabilities | |
| Accounts Payable | $ 56,337 |
| Public Works Trust Fund Loans (Current Portion) | 261,573 |
| USDA Bond (Current Portion) | 3,542 |
| Department of Retirement | 5,477 |
| Accrued Interest - Public Works Trust Fund & USDA Loans | 35,236 |
| Accrued Wages Payable | 10,628 |
| Accrued Payroll Taxes | 3,250 |
| Due to Developers | 3,543 |
| Payable from Restricted Assets: | |
| Revenue Bonds Outstanding - Net of Unamortized Bond Premium (Current Portion) | 523,708 |
| Bond Interest Payable | 31,872 |
| Total Current Liabilities | $ 935,166 |
| Noncurrent Liabilities | |
| Public Works Trust Fund Loans (Less Current Portion) | $ 2,111,497 |
| USDA Bond (Less Current Portion) | 220,756 |
| Compensated Absences | 20,943 |
| Payable from Restricted Assets: | |
| Revenue Bonds Outstanding - Net of Unamortized Bond Premium (Less Current Portion) | 6,653,963 |
| Total Noncurrent Liabilities | $ 9,007,159 |
| Total Liabilities | $ 9,942,325 |
| NET POSITION | |
| Net Investment in Capital Assets | $ 4,758,909 |
| Restricted for Capital Projects | 121,411 |
| Unrestricted | 2,280,416 |
| Total Net Position | $ 7,160,736 |

See accompanying notes to the financial statements

Valley Water District
Statement of Revenues, Expenses and Changes in Fund Net Position
Year Ended December 31, 2014

| | |
|---|---|
| Operating Revenues | |
| Water Revenues | $ 2,495,924 |
| Late Charges | 40,188 |
| Termination Notice/Charge | 22,770 |
| Water Availability Letters | 1,970 |
| Bill to Customer - Labor | 4,145 |
| Miscellaneous Income | 104,133 |
| Total Operating Revenues | $ 2,669,130 |
| Operating Expenses | |
| Operation & Pumping Expenses (Schedule) | $ 711,248 |
| General & Administrative Expenses (Schedule) | 572,807 |
| Depreciation Expense | 460,898 |
| Total Operating Expenses | $ 1,744,953 |
| Operating Income | $ 924,177 |
| Nonoperating Revenues (Expenses) | |
| Interest Income | $ 643 |
| Non-Operating Revenue | 7,500 |
| Interest Expense | (299,137) |
| Total Non-Operating Revenues (Expenses) | $ (290,994) |
| Income Before Contributions | $ 633,183 |
| Capital Contributions | 551,051 |
| Change in Net Position | $ 1,184,234 |
| Total Net Position - January 1 | 5,976,502 |
| Total Net Position - December 31 | $ 7,160,736 |

See accompanying notes to the financial statements

# Valley Water District
## Statement of Cash Flows
### Year Ended December 31, 2014

| | |
|---|---|
| Cash Flows From Operating Activities | |
| Cash Received From Customers | $ 2,665,356 |
| Cash Paid to Suppliers | (617,639) |
| Cash Paid to Employees | (668,040) |
| Net Cash Provided by Operating Activities | $ 1,379,677 |
| Cash Flows From Capital & Related Financing Activities | |
| Acquisition & Construction of Capital Assets | $ (282,770) |
| Proceeds from Sale of Fixed Assets | 7,500 |
| Principal Paid on Revenue Bonds | (510,000) |
| Principal Paid on Public Works Trust Fund Loans | (225,027) |
| Principal Paid on USDA Bond | (3,389) |
| Interest Paid on Capital Debt | (319,121) |
| Cash Contributions in Aid of Construction | 417,038 |
| Net Cash Provided (Used) by Capital & Related Financing Activities | $ (915,769) |
| Cash Flows From Investing Activities | |
| Interest Received on Investments | $ 584 |
| Net Cash Provided by Investing Activities | $ 584 |
| Net Increase (Decrease) in Cash & Cash Equivalents | $ 464,492 |
| Cash & Cash Equivalents - Beginning | $ 1,642,278 |
| Cash & Cash Equivalents - Ending | $ 2,106,770 |
| Noncash Investing, Capital & Financing Activities | |
| Contributions of Capital Assets from Developers | $ 134,013 |
| Book Value of Plant Removals | $ - |

See accompanying notes to the financial statements

Valley Water District
Statement of Cash Flows
Year Ended December 31, 2014

Reconciliation of Net Operating Income to
Net Cash Provided by Operating Activities

| | | |
|---|---|---|
| Net Operating Income | $ | 924,177 |
| | | |
| Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities: | | |
| Depreciation | $ | 460,898 |
| Change in Assets & Liabilities | | |
| (Increase) Decrease in Accounts Receivable | | 1,542 |
| (Increase) Decrease in Accrued Utility Revenue | | (5,316) |
| (Increase) Decrease in Inventory | | 6,456 |
| (Increase) Decrease in Prepaid Insurance | | (1,361) |
| Increase (Decrease) in Accounts Payable | | (12,809) |
| Increase (Decrease) in Department of Retirement Payable | | (22) |
| Increase (Decrease) in Accrued Wages Payable | | (2,229) |
| Increase (Decrease) in Accrued Payroll Taxes | | 150 |
| Increase (Decrease) in Accrued Compensated Absences | | 4,944 |
| Increase (Decrease) in Unamortized Bond Insurance | | 3,247 |
| Total Adjustments | $ | 455,500 |
| Net Cash Provided by Operating Activities | $ | 1,379,677 |

See accompanying notes to the financial statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Valley Water District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The Governmental Accounting Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the most significant accounting policies of the District:

a. Reporting Entity
Valley Water District is a municipal corporation governed by an elected 3 member board. The District's primary activity is to provide water services to residential and commercial customers within the District's boundaries. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

b. Basis of Accounting and Presentation
The accounting records of the District are maintained in accordance with methods prescribed by the Washington State Auditor under the authority of Chapter 43.09 RCW. The District uses the uniform system of accounts for water utilities as prescribed by the National Association of Regulatory Utility Commissioners.

The District uses the full-accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Capital asset purchases are capitalized and long-term liabilities are accounted for in the appropriate funds. Unbilled utility service receivables are recorded at year end.

The District distinguishes between operating revenues and expenses and nonoperating revenues and expenses. Operating revenues and expenses result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for water sales and related services. Operating expenses pertain to the furnishing of those services which include the cost of sales and services, administration expenses and depreciation expense. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

c. Cash and Cash Equivalents
For purposes of the statement of cash flows, the District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

d. Capital Assets

Utility plant in service is recorded at cost. Donations by developers are recorded at the contract price. Depreciation is calculated on the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Utility Plant | 5 - 75 years |
| Machinery & Equipment | 5 - 40 years |
| Intangibles | 5 years |

Upon retirement of an asset, the cost of the asset and the related accumulated depreciation are removed from the property accounts and the gain or loss is reflected in the statement of revenues, expenses and changes in fund net position.

Repairs and maintenance are expensed as incurred, while major renewals, replacements and betterments are capitalized. The District has a policy that any capital expenditure under $1,000 is expensed.

Preliminary planning and design costs incurred for proposed projects are held pending construction of the facility. Costs relating to projects which are ultimately constructed are transferred to capitalized utility plant. Costs relating to those projects abandoned are charged to expense when it is determined that they will not be completed. See Note 3.

e. Restricted Funds

In accordance with bond resolutions separate restricted funds are required to be established. The bond fund was the only restricted fund at the end of 2014.

f. Receivables

Receivables consist primarily of amounts due from water customers. All receivables are recorded when earned. There may also be amounts due from developers and other districts and municipalities. No allowance for uncollectible accounts is provided since the District has the power to record liens for its receivables and, generally, does not experience significant uncollectible amounts.

g. Inventories

Inventories are valued at average cost, which approximates market value. A physical inventory is taken at the end of each calendar year.

h. Investments

Investments are recorded at cost, which generally approximates market value. The investments are expected to be held to maturity. Any significant premium or discount existing at the time of purchase of the investment is amortized to the maturity date. See Note 2.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

i. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records unpaid leave for compensated absences as an expense and liability when incurred. Following one year of employment, employees may accrue a maximum of 240 hours of vacation. Upon separation from employment after three years of continuous employment, an employee shall receive pay for 50% of any accrued sick leave over 288 hours at the hourly rate of pay on the date of separation.

j. Unamortized Bond Insurance

Bond insurance is deferred and amortized over the lives of the various bond issues.

k. Unemployment Insurance

The District is on the reimbursable method with the State of Washington for unemployment compensation. The District does not have a reserve account for this liability, should it occur.

l. Subsequent Events

Management has evaluated subsequent events through April 30, 2015, the date the financial statements were available to be issued.

NOTE 2 - DEPOSITS AND INVESTMENTS

The District's deposits and certificates of deposit are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

The Pierce County Treasurer follows the state statutes which authorize the District to invest in obligations of the U.S. Government, Banker's Acceptances, or deposits with Washington State banks and savings and loan institutions.

Listed below are the District's cash and investments at December 31, 2014:

| | |
|---|---|
| Cash on hand | $ 1,100 |
| Bank deposits | 84,326 |
| Cash on deposit with Pierce County Treasurer | 128,344 |
| Investment in State Investment Pool | 1,893,000 |
| Total Cash & Investments | $ 2,106,770 |

NOTE 2 - DEPOSITS & INVESTMENTS (Continued)

Credit risk - As of December 31, 2014, the District's investment in the Pool was not rated by a nationally recognized statistical rating organization (NRSPO).

Interest rate risk - The Pool is a 2a-7 like pool. Consequently, the District's investments in the Pool are not subject to interest rate risk as the weighted average maturity of the Pool's portfolio will not exceed 90 days.

The District does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value arising from increasing interest rates.

NOTE 3 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2014 was as follows:

| | Beginning Balance | Increase | Decrease | Ending Balance |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | $ 845,964 | $ - | $ - | $ 845,964 |
| Construction in Progress | 1,707,560 | 170,744 | 7,387 | 1,870,917 |
| Total capital assets not being depreciated | 2,553,524 | 170,744 | 7,387 | 2,716,881 |
| Capital assets being depreciated: | | | | |
| Plant | 16,091,939 | 215,348 | - | 16,307,287 |
| Machinery & Equipment | 589,200 | 63,750 | 31,436 | 621,514 |
| Intangibles | 205,094 | - | - | 205,094 |
| Total capital assets being depreciated | 16,886,233 | 279,098 | 31,436 | 17,133,895 |
| Less accumulated depreciation for: | | | | |
| Plant | 4,369,214 | 419,196 | - | 4,788,410 |
| Machinery & Equipment | 405,139 | 35,374 | 31,436 | 409,077 |
| Intangibles | 173,458 | 6,328 | - | 179,786 |
| Total accumulated depreciation | 4,947,811 | 460,898 | 31,436 | 5,377,273 |
| Total capital assets being depreciated, net | 11,938,422 | (181,800) | - | 11,756,622 |
| TOTAL CAPITAL ASSETS, NET | $ 14,491,946 | $ (11,056) | $ 7,387 | $ 14,473,503 |

The District's total interest cost was $335,380 in 2014, of which $36,243 was capitalized as construction period interest.

NOTE 4 - CONSTRUCTION IN PROGRESS

Construction in progress represents expenses to date on projects whose authorizations total $1,870,917. Of the committed balance of $80,000, the District will not be required to raise future financing.

| | Project Authorization | Expended to 12/31/14 | Committed | Required Future Financing |
|---|---|---|---|---|
| Master Meter Study | $ 8,828 | $ 8,828 | $ - | $ - |
| Chinook Treatment | 1,862,089 | 1,862,089 | - | - |
| | $ 1,870,917 | $ 1,870,917 | $ - | $ - |

NOTE 5 - LONG-TERM DEBT AND LIABILITIES

a. Revenue Bonds

A summary of bonds outstanding at December 31, 2014 is as follows:

| | |
|---|---|
| 2006 Water Revenue Refunding Bonds, 3.35% - 3.875%, maturing serially through 2018 | $ 960,000 |
| 2007 Water Improvement and Refunding Revenue Bonds, 4.0% - 4.5%, maturing serially through 2032 | 3,815,000 |
| 2011 Water Improvement and Refunding Revenue Bonds, 4.0% - 4.5%, maturing serially through 2031 | 880,000 |
| 2012 Water Revenue Bonds, 3.5%, maturing serially through 2032 | 1,485,000 |
| | $ 7,140,000 |

The District issued $2,215,000 of Water Revenue Refunding Bonds dated March 7, 2006. The advance refunding was undertaken to reduce debt service payments over the next twelve years by $97,622 and resulted in an economic gain of $226,877. The District defeased certain bonds of the 1998 bond issue by placing investments acquired from the proceeds of the new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust accounts and the defeased bonds are not included in the District's financial statements. At December 31, 2006, $2,080,000 of the 1998 water revenue bonds are considered defeased. The difference between the cost to defease outstanding debt and the carrying value of the bonds defeased by refunding

NOTE 5 - LONG-TERM DEBT AND LIABILITIES (Continued)

a. Revenue Bonds (Continued)

bonds is deferred and amortized over the shorter of the remaining term of the refunded bonds or the term of the new refunding bonds.

The District issued $4,780,000 of Water Improvement and Refunding Revenue Bonds dated July 5, 2007. The bond was used to finance various system improvements and advance refund the callable portion of the District's outstanding 2002 Water Revenue Bonds.

On August 2, 2011, the District adopted resolution No. 2011-05 providing for the issuance of $1,000,000 par value Water Improvement and Refunding Revenue Bonds, 2011, of the District for the purpose of paying for a part of the cost of constructing a new treatment plant for the District's Chinook water system, including related system upgrades and improvements and to repay a Public Works Trust Fund loan of the District.

On November 20, 2012, the District adopted resolution No. 2012-04 providing for the issuance of $1,620,000 par value Water Revenue Bonds, 2012, of the District to purchase a private water system and construct improvements to an existing water plant.

Trustees hold direct obligations of the U.S. Government in irrevocable escrows for the defeasance of all refunded bonds. Cash flow from these escrowed investments matches the principal and interest payments of the defeased obligations.

The principal and interest on water revenue bonds are payable from and secured by a pledge of net operating revenues and collection of Utility Local Improvement District assessments, including interest thereon. In addition, bond resolutions require that bond funds, as shown in the accompanying statement of net position, be established and accumulated for the payment of maturing principal and interest.

The annual requirements to amortize all revenue bonds outstanding as of December 31, 2014, including interest, are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2015 | $ 520,000 | $ 277,262 | $ 797,262 |
| 2016 | 540,000 | 260,120 | 800,120 |
| 2017 | 560,000 | 242,100 | 802,100 |
| 2018 | 585,000 | 222,046 | 807,046 |
| 2019 | 335,000 | 200,475 | 535,475 |
| 2020 - 2024 | 1,625,000 | 817,720 | 2,442,720 |
| 2025 - 2029 | 1,790,000 | 485,350 | 2,275,350 |
| 2030 - 2032 | 1,185,000 | 98,475 | 1,283,475 |
| | $ 7,140,000 | $ 2,603,548 | $ 9,743,548 |

NOTE 5 - LONG-TERM DEBT AND LIABILITIES (Continued)

b. Department of Agriculture Loan

The District has entered into an agreement with the United States Department of Agriculture to receive the following loan for the Warden Estates improvement.

| | |
|---|---|
| 2005 loan - payable at $6,798 semiannually (including interest at 4.5% per annum) through the year 2045 Original debt: $250,000 | $ 224,298 |

The annual requirements to amortize the Department of Agriculture loan outstanding as of December 31, 2014, including interest, are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2015 | $ 3,542 | $ 10,054 | $ 13,596 |
| 2016 | 3,703 | 9,893 | 13,596 |
| 2017 | 3,871 | 9,725 | 13,596 |
| 2018 | 4,048 | 9,548 | 13,596 |
| 2019 | 4,232 | 9,364 | 13,596 |
| 2020 - 2024 | 24,229 | 43,751 | 67,980 |
| 2025 - 2029 | 30,267 | 37,713 | 67,980 |
| 2030 - 2034 | 37,809 | 30,171 | 67,980 |
| 3035 - 2039 | 47,232 | 20,748 | 67,980 |
| 2040 - 2044 | 59,002 | 8,978 | 67,980 |
| 2045 | 6,363 | 428 | 6,791 |
| | $ 224,298 | $ 190,373 | $ 414,671 |

c. Public Works Trust Fund Loans and State Revolving Fund Loan

The District has entered into agreements with the Department of Community, Trade and Economic Development of the State of Washington to receive the following Public Works Trust Fund Loans and State Revolving Fund Loan for various capital improvements:

| | |
|---|---|
| 1996 loan - payable at $28,933 annually through the year 2016, plus interest at 1% per annum Original debt: $518,400. | $ 57,865 |
| 1996 loan - payable at $25,203 annually through the year 2016, plus interest at 2% per annum Original debt: $496,800. | 50,406 |

NOTE 5 - LONG-TERM DEBT AND LIABILITIES (Continued)

c. Public Works Trust Fund Loans and State Revolving Fund Loan (Continued)

| | |
|---|---|
| 1996 loan - payable at $24,761 annually through the year 2016, plus interest at 3% per annum Original debt: $509,400. | 49,523 |
| 2001 loan - payable at $31,609 annually through the year 2021, plus interest at ½% per annum Original debt: $595,000. | 221,266 |
| 2004 loan - payable at $72,454 annually through the year 2024, plus interest at ½% per annum Original debt: $1,220,600. | 724,538 |
| 2002 loan - payable at $15,239 annually through the year 2023, plus interest at 1½% per annum Original debt: $275,400 | 137,150 |
| 2003 loan - payable at $13,515 annually through the year 2024, plus interest at 1½% per annum Original debt: $294,920. | 135,149 |
| 2013 loan - payable at $49,859 annually through the year 2034, plus interest at 0% per annum Original debt: $997,173. | 997,173 |
| | $ 2,373,070 |

The annual requirements to amortize all Public Works Trust Fund and State Revolving Fund loans outstanding as of December 31, 2014, including interest, are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2015 | $ 261,573 | $ 49,267 | $ 310,840 |
| 2016 | 261,572 | 23,608 | 285,180 |
| 2017 | 182,676 | 20,372 | 203,048 |
| 2018 | 182,675 | 18,673 | 201,348 |
| 2019 | 182,676 | 16,973 | 199,649 |
| 2020 - 2024 | 803,311 | 59,847 | 863,158 |
| 2025 - 2029 | 249,293 | 29,915 | 279,208 |
| 2030 - 2034 | 249,294 | 11,217 | 260,511 |
| | $ 2,373,070 | $ 229,872 | $ 2,602,942 |

NOTE 5 - LONG-TERM DEBT AND LIABILITIES (Continued)

d. Changes in Long-Term Liabilities

During the year ended December 31, 2014, the following changes occurred in long-term debt:

| | Balance 1/1/14 | Additions | Reductions | Balance 12/31/14 | Due Within One Year |
|---|---|---|---|---|---|
| Revenue Bonds Payable | $ 7,650,000 | $ - | $ 510,000 | $ 7,140,000 | $ 520,000 |
| Unamortized Bond Premium | 41,558 | - | 3,887 | 37,671 | 3,708 |
| Department of Agriculture Loan | 227,687 | - | 3,389 | 224,298 | 3,542 |
| Public Works Trust Fund Loans | 2,598,097 | - | 225,027 | 2,373,070 | 261,573 |
| Compensated Absences | 15,999 | 4,944 | - | 20,943 | - |
| Totals | $ 10,533,341 | $ 4,944 | $ 742,303 | $ 9,795,982 | $ 788,823 |

There are a number of limitations and restrictions contained in the various bond indentures. The District is in compliance with all significant limitations and restrictions.

NOTE 6 - PENSION PLAN

Substantially all District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov.

NOTE 6 - PENSION PLAN (Continued)

**Public Employees' Retirement System (PERS) Plans 1, 2 and 3**

Plan Description

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts; employees of legislative committees; employees of district and municipal courts; and employees of local governments. Membership also includes higher education employees not participating in higher education retirement programs. Approximately 49 percent of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component.

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to Plan 3.

PERS is comprised of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for accounting purposes.

PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the Director of DRS. During DRS' Fiscal Year 2013, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon, in lieu or any retirement benefit, upon separation from PERS-covered employment.

NOTE 6 - PENSION PLAN (Continued)

PERS Plan 1 members are vested after the completion of five years of eligible service.

PERS Plan 1 members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with 25 years of service, or at age 60 with 5 years of service. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits.

The monthly benefit is 2 percent of the average final compensation (AFC) per year of service, but the benefit may not exceed 60 percent of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months.

PERS Plan 1 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity. The benefit amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60, at which time the benefit is converted to the member's service retirement amount.

A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. Plan 1 members may elect to receive an optional COLA amount (based on the Consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest paid service months. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually.

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

NOTE 6 - PENSION PLAN (Continued)

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions, if hired prior to May 1, 2013:

- With a benefit that is reduced by 3 percent for each year before age 65; or
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of 5 percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service.

PERS Plan 2 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. As established by Chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 percent to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a 5 percent rate. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, PERS Plan 3 contributions are invested in the Retirement Strategy Fund that assumes the member will retire at age 65.

For DRS' fiscal year 2013, PERS Plan 3 employee contributions were $99.0 million, and plan refunds paid out were $69.4 million.

The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 by June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, and were hired before May 1, 2013, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

NOTE 6 - PENSION PLAN (Continued)

- If they have 30 service credit years, are at least 55 years old, and were hired after May 1, 2013, they have the option to retire early by accepting a reduction of 5 percent for each year before age 65.

PERS Plan 3 benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service. These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors.

A one-time duty-related death benefit is provided to the beneficiary or the estate of a PERS member who dies as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of the member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,176 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans as of June 30, 2013:

| | |
|---|---|
| Retirees and Beneficiaries Receiving Benefits | 85,328 |
| Terminated Plan Members Entitled To But Not Yet Receiving Benefits | 31,047 |
| Active Plan Members Vested | 150,706 |
| Active Plan Members Nonvested | 101,191 |
| Total | **368,272** |

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan I are established by statute at 6 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5 percent to 15 percent.

NOTE 6 - PENSION PLAN (Continued)

Funding Policy (Continued)

The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2014 were as follows:

| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
|---|---|---|---|
| Employer* | 9.21%** | 9.21%** | 9.21%*** |
| Employee | 6.00%**** | 4.92%**** | ***** |

*The employer rates include the employer administrative expense fee currently set at 0.18%.
**The employer rate for state elected officials is 13.73% for Plan 1 and 9.21% for Plan 2 and Plan 3.
***Plan 3 defined benefit portion only.
****The employee rate for state elected officials is 7.5% for Plan 1 and 4.92% for Plan 2.
*****Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ended December 31 were as follows:

| | PERS Plan 1 | PERS Plan 2 | PERS Plan 3 |
|---|---|---|---|
| 2014 | $ - | $ 38,929 | $ 2,271 |
| 2013 | $ - | $ 30,980 | $ 1,871 |
| 2012 | $ - | $ 24,398 | $ 1,635 |

NOTE 7 - DEFERRED COMPENSATION PLAN

The District began offering its employees a deferred compensation plan during 2012. The Plan is administered by the Washington Department of Retirement Services (DRS). The plan was created in accordance with Internal Revenue Code 457. The plan is available to all District employees, which allows a deferral of a portion of their taxable wages until future years. A distribution from the deferred compensation plan to an employee is allowed at termination of employment, retirement, death, or under certain emergencies. The District does not administer or manage the deferred compensation plan, but instead all amounts are the property of the employee. The plan was established to replace the participation of employees in the Social Security System.

NOTE 8 - RISK MANAGEMENT

The District is member of the Water and Sewer Risk Management Pool (Pool). Chapter 48.62 RCW authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self-insurance, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The Pool was formed in November 1987 when water and sewer districts in the State of Washington joined together by signing an Interlocal Governmental Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. The Pool currently has 68 members. The Pool's fiscal year is November 1st through October 31st.

The Pool allows members to jointly purchase insurance coverage, establish a plan of self-insurance coverage, and provide related services, such as risk management and loss prevention. The Pool provides the following forms of group purchased insurance coverage for its members: Property (including Building, Electronic Data Processing, Boiler and Machinery, and Mobile Equipment); General Liability; Automotive Liability; Excess Liability; Crime; Public Officials Liability; Identity Fraud Reimbursement Program; and bonds of various types. All coverages are on an “occurrence” basis.

Members make an annual contribution to fund the Pool. The Pool purchases insurance policies from unrelated underwriters as follows:

| TYPE OF COVERAGE | MEMBER DEDUCTIBLE | SELF-INSURED RETENTION | EXCESS LIMITS |
|---|---|---|---|
| **Property Loss:** | | | |
| Buildings and Contents | \$1,000 - \$10,000 and See (C) below | \$25,000 | \$1,000,000,000 |
| Flood | See (A) below | See (A) below | \$50,000,000 |
| Earthquake | See (B) below | See (B) below | \$75,000,000 (\$25,000,000 dedicated to Alderwood and \$50,000,000 shared by all members) |
| Terrorism | \$1,000 - \$10,000 | \$25,000 Primary layer | \$100,000,000 Primary layer |
| Boiler & Machinery | \$1,000 - \$350,000 depending on object | \$25,000 - \$350,000 depending on object | \$100,000,000 |
| Auto - Physical Damage | \$1,000 - \$10,000 | \$25,000 | \$10,000,000 |

NOTE 8 - RISK MANAGEMENT (Continued)

| TYPE OF COVERAGE | MEMBER DEDUCTIBLE | SELF-INSURED RETENTION | EXCESS LIMITS |
|---|---|---|---|
| **Liability:** | | | |
| Commercial General Liability | $1,000 - $10,000 | $200,000 | $10,000,000 |
| Auto Liability | $1,000 - $10,000 | $200,000 | $10,000,000 |
| Public Officials Errors and Omissions | $1,000 - $10,000 | $200,000 | $10,000,000 |
| Employment Practices | $1,000 - $10,000 | $200,000 | $10,000,000 |
| **Other:** | | | |
| Public Officials Bonds | Various | N/A | Various |
| Crime | $1,000 - $10,000 | $25,000 | $2,000,000 |
| Identity Fraud | $0 | $25,000 | $0 |
| A. $100,000 member deductibles, per occurrence, in Flood Zones except Zones A&V; $250,000 member deductible, per occurrence, in Flood Zones A&V. | | | |
| B. Member deductible for earthquakes is 5% subject to $100,000 minimum Earthquake Shock. If the stated deductible is on a percentage basis, the deductible will apply per occurrence on a per unit basis, as defined in the policy form, subject to the stated minimum. | | | |
| C. Member deductible for Cyber liability is $100,000 and where applicable the dollar amount of the business interruption loss during the policy's required 8 hour waiting period. | | | |

Pool members are responsible for a deductible on each coverage and the Pool is responsible for the remainder of the self-insured retention listed in the table above except where noted as follows. The insurance carriers then cover the loss to the maximum limit of the policy. Each member is responsible for the full deductible applicable to the perils of earthquake and flood (the Pool is not responsible for any deductible or self-insured retention for earthquake and flood claims). Each member is also responsible for the full deductible applicable to the Cyber Liability, and that part of a Boiler & Machinery deductible which exceeds $25,000.

Upon joining, the members contract to remain in the Pool for one full policy period. Following completion of one full policy period, members must give six months' notice before terminating participation (e.g. to withdraw from the Pool on November 1, 2015, written notice must be in the Pool possession by April 30, 2015). The Interlocal Governmental Agreement is renewed automatically each year. Even after termination of relationship with the Pool, a member is still responsible for contributions to the Pool for any unresolved, unreported, and in process claims, for the period that the District was a signatory to the Interlocal Governmental Agreement.

The Pool is fully funded by its member participants. Claims are filed by members with the Pool who determines coverage and performs claims adjustment in consultation with Arcadia Claims Services.

The Pool is governed by a Board of Directors, which is comprised of one designated representative from each participating member. An Executive Committee is elected at the annual meeting, and is responsible for overseeing the business affairs of the Pool and providing policy direction to the Pool's Executive Director.

For years ending December 31, 2012, 2013, and 2014 the District had no claims in excess of their insurance coverage.

## NOTE 9 - USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## NOTE 10 - CONTINGENT LIABILITIES

The District's financial statements include all material liabilities. There are no material contingent liabilities to record.

## NOTE 11 - ACCOUNTING AND REPORTING CHANGES

The District implemented GASB 65, *Items Previously Reported as Assets and Liabilities*. This standard states in part, "Debt issuance costs, except any portion related to prepaid insurance costs, should be recognized as an expense in the period incurred. Prepaid insurance costs should be reported as an asset and recognized as an expense in systematic and rational manner over the duration of the related debt."

This statement also states in part, "Accounting changes adopted to conform to the provisions of this statement should be applied retroactively by restating the financial statements, if practical, for all periods presented."

Implementation of the standard requires the District to reclassify the applicable 2006, 2007, 2011 and 2012 unamortized bond issuance costs from an asset account to change in application of accounting principle in the amount of $138,658.

## NOTE 12 - HEALTH & WELFARE

The District is a member of the Association of Washington Cities Employee Benefit Trust Health Care Program (AWC Trust HCP). Chapter 48.62 RCW provides that two or more local government entities may, by Interlocal agreement under Chapter 39.34 RCW, form together or join a pool or organization for the joint purchasing of insurance, and/or joint self-insurance, to the same extent that they may individually purchase insurance, or self-insure.

An agreement to form a pooling arrangement was made pursuant to the provisions of Chapter 39.34 RCW, the Interlocal Cooperation Act. The AWC Trust HCP was formed on January 1, 2014 when participating cities, towns, and non-city entities of the AWC Employee Benefit Trust in the State of Washington joined together by signing an Interlocal Governmental Agreement to jointly self-insure certain health benefit plans and programs for participating employees, their covered dependents and other beneficiaries through a designated account within the Trust.

As of December 31, 2014, 263 cities/towns/non-city entities participate in the AWC Trust HCP.

NOTE 12 -<u>HEALTH & WELFARE (Continued)</u>

The AWC Trust HCP allows members to establish a program of joint insurance and provides health and welfare services to all participating members. The AWC Trust HCP pools claims without regard to individual member experience. The pool is actuarially rated each year with the assumption of projected claims run-out for all current members. The AWC Trust HCP includes medical insurance through Regence BlueShield and Asuris Northwest Health, dental insurance through Delta Dental of Washington, and vision insurance through Vision Service Plan. Eligible members are cities and towns within the state of Washington. Non-city Entities (public agency, public corporation, intergovernmental agency, or political subdivision within the state of Washington) are eligible to apply for coverage into the AWC Trust HCP, submitting application to the Board of Trustees for review as required in the Trust Agreement.

Participating employers pay monthly premiums to the AWC Trust HCP. The AWC Trust HCP is responsible for payment of all covered claims. The AWC Trust HCP purchases stop loss insurance for Regence/Asuris plans at individual Stop Loss (ISL) of $1.5 million through Life Map, and Group health ISL at $750,000 through Sun Life. The aggregate policy is for 200% of expected medical claims.

Participating employers contract to remain in the AWC HCP for a minimum of three years. Participating employers with over 250 employees must provide written notice of termination of all coverage a minimum of 12 months in advance of the termination date, and participating employers with under 250 employees must provide written notice of termination of all coverage a minimum of 6 months in advance of termination date. When all coverage is being terminated, termination will only occur on December 31. Participating employers terminating a group or line of coverage must notify the HCP a minimum of 60 days prior to termination. A participating employer's termination will not obligate that member to past debts, or further contributions to the HCP. Similarly, the terminating member forfeits all rights and interest to the HCP Account.

The operations of the Health Care Program are managed by the Board of Trustees or its delegates. The Board of Trustees is comprised of four regionally elected officials from Trust member cities or towns, the Employee Benefit Advisory Committee Chair and Vice Chair, and the AWC Board of Directors President and Vice President. The Trustees or its appointed delegates review and analyze Health Care Program related matters and make operational decisions regarding premium contributions, reserves, plan options and benefits in compliance with Chapter 48.62 RCW. The Board of Trustees has decision authority consistent with the Trust Agreement, Health Care Program policies, Chapter 48.62 RCW and Chapter 200-110-WAC.

The accounting records of the Trust HCP are maintained in accordance with methods prescribed by the State Auditor's office under the authority of Chapter 43.09 RCW. The Trust HCP also follows applicable accounting standards established by the Governmental Accounting Standard Board ("GASB"). Year-end financial reporting is done on an accrual basis and submitted to the Office of the State Auditor as required by Chapter 200-110 WAC. The audit report for the AWC Trust HCP is available from the Washington State Auditor's office.

## ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as fraud, state whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our website and through our free, electronic subscription service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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